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Message Text

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ACTION EA-10

INFO OCT-01 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

TRSE-00 SS-15 STR-04 OMB-01 CEA-01 ABF-01 AGR-05 A-01

OPR-02 FRB-03 CIAE-00 INR-07 NSAE-00 L-03 FS-01

COME-00 /075 W
---------- 006956
R 210916Z JUL 75
FM AMEMBASSY MANILA
TO SECSTATE WASHDC 5660
INFO AMEMBASSY BANGKOK
AMEMBASSY CANBERRA
AMCONSUL HONG KONG
AMEMBASSY JAKARTA
AMEMBASSY KUALA LUMPUR
AMEMBASSY SEOUL
AMEMBASSY SINGAPORE
AMEMBASSY TAIPEI
AMEMBASSY TOKYO
AMEMBASSY WELLINGTON

C O N F I D E N T I A L MANILA 9966

E.O. 11652: GDS
TAGS: EFIN, EGEN, RP
SUBJECT: PHILIPPINE EXCHANGE RATE

REF: MANILA 9769; MANILA 9875

SUMMARY. LARGELY UNCHALLENGED FLOAT OF THE PESO THIS PAST WEEK HAS GENERATED CONSIDERABLE DEBATE IN PHILIPPINE FINANCIAL CIRCLES AS TO WHY CENTRAL BANK GOVERNOR LICAROS DECIDED TO LET THE PESO SLIDE VIS-A-VIS THE DOLLAR AT THIS TIME. REASONS ADVANCED BY VARIOUS SOURCES RAGEN ACROSS: (A) SPECULATIVE REACTION TO FIRST SEMESTER 1975 BALANCE OF PAYMENTS RESULTS, (B) AN ATTEMPT TO DAMPEN IMPORT RATES, OR (C) TO IMPORVE EXPORT PROSPECTS, (D) TO HELP THE PHILIP-
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PINE NATIONAL BANK RECOUP SOME IF ITS LOSSES FROM HOLDING

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THE BAG OF BACKLOGGED SUGAR INVENTORY, AND (E) TO KEEP PHILIPPINE OFFICIALS RESERVES AT PRESENT HIGH LEVELS RATHER THAN TRANSFER SIZEABLE RESERVES INTO PRIVATE HANDS VIA DEFENSE OF THE PESO. GENERALLY AGREED, AND PRIVATELY CONCEDED BY THE SECRETARY OF FINANCE,IS THAT THERE WAS LITTLE NEED FOR ANY SIGNIFICANT ADJUSTMENT OF THE PESO/DOLLAR PARITY. IN THE MEANTIME, THE SPECULATIVE HEAT APPEARED TO WANE WITH THE GUIDING RATE SET FOR THE OPENING OF BUSINESS MONDAY AT P7.599 -$1.00. SETTLING THROUGH THE DAY'S TRADING AT P7.565-$1.00. MANY SEEM TO FEEL THAT ADJUSTMENT IN THIS RANGE AT WORST WOULD DO NO HARM. END SUMMARY

1. FIRST SEMESTER 1975 BALANCE OF PAYMENTS RESULTS, AS THESE APPARENTLY ARE CONTAINED IN THE QUARTERLY REPORT OF THE CENTRAL BANK TO THE PRESIDENT (NOT YET AVAILABLE), SHOW A SIX MONTH BALANCE OF PAYMENTS DEFICIT OF $265 MILLION, REPRESENTING A SHARP UPTURN FROM AVERAGE MONTHLY DEFICITS OF AROUND $35 MILLION DURING JANUARY-MAY. THIS RANGE OF FEFICIT IS STILL, HOWEVER, WELL WITHIN THE ESTIMATES OF, INTER ALIA, THE IMF, AND WHILE IT SHOULD SPUR EFFORTS TO LIMIT IMPORTS, IT IS CUSHIONED BY A STILL SIZEABLE RESERVE OF OVER $1 BILLION, AND SHOULD BE NO CAUSE FOR PANIC. THE RESULT, IN ANY CASE, PROVIDED SPECULATIVE GRIST AS IT LEAKED TO THE PUBLIC.

2. A DECISION TO DAMPEN THE RATE OF IMPORTS, IF NOW DEFINITE, HAS BEEN RELUCTANTLY MADE.THE STRUCTURE OF IMPORTS IN SUCH THAT MAIN IMPACT OF ADJUSTMENT IS LIKELY TO FALL ON DEVELOPMENTAL IMPORTS, WITH CONSEQUENT SLOWING OF THE RATE OF GROWTH. SOME HAVE ARGUED FOR SUCH A SLOWING, AT LEAST UNTIL MAJOR EXPORT MARKETS PICK UP AGAIN, BUT THE PRESIDENT HAS NOT LIKED THIS IDEA, ESPECIALLY BECAUSE OF HIS CONCERN ABOUT THE EFFECTS OF REDUCED EMPLOYMENT IN THE CITIES ON SUPPORT FOR HIS NEW SOCIETY. NEITHER IS THE LIKELY FILLIP TO THE RATE OF URBAN PRICE INFLATION, THAT READILY WILL FLOW FROM A WEAKENDED PESO,GOING TO BE RECEIVED WITH ANY JOY IN THE PALACE.

3. EXPORT STIMULATION REMAINS, AS EVER, A CHIMERICAL MOTIVE FOR CHANGE IN THE PESO.SUCH TRADE GAINS AS THERE ARE REMAIN FRAUGHT WITH RISK. WHILE THE PHILIPPINES IS THE CONFIDENTIAL

LARGEST SINGLE SOURCE OF COCONUT OIL AND COPRA, THE SCALE AND RANGE OF AVAILABLE SUBSTITUTES HARDLY SETS UP THE PHILIPPINES AS PRICE MAKER, AND THE COUNTRY IS EVEN MORE A PRICE TAKER ON OTHER KEY EXPORTS. UNLESS MAJOR EXPORT MARKETS PICK UP WITH RECOVERY IN THE U.S., JAPAN AND WESTERN EUROPE, THE SLIGHT NUDGE TO EXPORTS OF IMPROVED COMPETITIVENESS VERY LIKELY WOULD BE LOST IN REDUCED UNIT RETURNS ON A STATIC VOLUME OF SALES.

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4. THE PROSPECT THAT PNB MIGHT TRY TO RECUOUPTS LOSSES FROM SUGAR HOLDINGS CANNOT BE DISREGARDED EVEN THOUGH THE PROBLEM IS AN INTERNAL ONE. PNB ALREADY HAS PAID THE MILLS FOR MUCH OF THIS SEASON'S CROP AT A FIXED PRICE OF SOMEWHAT MORE THAN 11 CENTS PER POUND. WHILE THE MILLS ARE ABSORBING STORAGE COSTS, THE COST OF MONEY TIED UP IN AN INVENTORY EXCEEDING A MILLION TONS IS COMING OUT OF PNB'S HIDE. CLOSING THE CENTRAL BANK REDISCOUNT WINDOW WHILE THE PESO FLOATED LAST WEEK GAVE A STIFF UPWARD SHOVE TO SHORT TERM INTEREST RATES, TOWARD 24 PERCENT. WITH MORE DOLLARS TO SELL THAN ANYONE ELSE (SAVE THE CB) AND PESOS TO LEND, THE PNB NO DOUBT HAS OFFSET A SIZEABLE PORTION OF ITS SUGAR CARRYING CHARGE, EFFECTIVELY TRANSCERRING THE BURDEN TO PRIVATE BANKS. AT THE SAME TIME SPECULATIVE TENDENCIES OF THE COMMERCIAL BANKS HAVE BEEN HEAVILY STIFLED BY THEIR NEED TO SELL DOLLARS TO COVER PESO NEEDS NOT SERVICEABLE AT THE REDISCOUNT WINDOW.

5. FINALLY, ONE OF THE MOST POPULAR MOTIVES, THAT IS WIDELY THOUGHT TO BE THE OPERATIONAL ONE, IS A CB URGE TO KEEP OFFICIAL RESERVES INTACT. THERE WAS, AT THE BEGINNING OF THE FLOAT LAST MONDAY, A RELUCTANCE TO SELL OFFICIAL DOL-LAR RESERVES, THEREBY TRANSFERRING GREATER CONTROL OF THE COUNTRY'S TOTAL RESERVES TO PRIVATE BANKS. WHO WOULD BE EXPECTED UNDER THIS THEORY OF THE PROBLEM TO CONTINUE HOLDING ON TO THEIR DOLLARS, WHILE ACQUIRING IN DUE COURSE THE PROCEEDS OF CB DOLLAR SALES. AN ARTICLE OF FAITH AMONG MANILA BANKERS AT THE MOMENT IS THAT LICAROS IS DEEPLY ATTACHED--UNDER HEAVY PRESSURE FROM MALACANANG--TO THE LARGE OFFICIAL RESERVE NUMBER, DESPITE THE NEED FOR CONTINUED SIZEABLE EXTERNAL BORROWINGS TO SUSTAIN IT.

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6. YET ANOTHER THEORY IS THAT SOMEWHERE LURK HIDDEN BENEFICIARIES OF A SPECULATIVE ASSAULT ON THE PESO. WHILE IT MAY BE A SORT OF QUOTE LOST DAUPHIN UNQUOTE THEORY OF PHILIPPINE MONETARY POLICY, THIS THEORY HAS A CERTAIN RING AMOUNG THOSE MOST ACUTELY AWARE OF THE DRIFT OF ECONOMIC POWER TOWARD THE PALANCE. IF UNTRUE, OF COURSE, IT WILL REMAIN BEYOND REFUTATION.

7. STICKING MORE PRECISELY TO THE SUBJECT, IT WULD APPEAR THAT MARGINAL GAINS IN PROSPECT OUTWEIGH MARGINAL LOSSES, SO LONG AS THE PESO IS NOT ALLOWED TO DRIFT, OR TO BE PUSHED, FAR FROM WHERE IT NOW SEEMS TO HAVE COME TO REST. SULLIVAN

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